

Report  
of the  
Examination of  
Ellington Mutual Insurance Company  
Hortonville, Wisconsin  
As of December 31, 2000

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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June 21, 2001

Honorable Connie L. O'Connell  
Commissioner of Insurance  
State of Wisconsin  
121 East Wilson Street  
Madison, WI 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the  
affairs and financial condition of:

ELLINGTON MUTUAL INSURANCE COMPANY  
Hortonville, Wisconsin

and this report is respectfully submitted.

## **I. INTRODUCTION**

The previous examination of the company was conducted in 1996 as of December 31, 1995. The current examination covered the intervening period ending December 31, 2000, and included a review of such 2001 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the

completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

## **II. HISTORY AND PLAN OF OPERATION**

The company was originally organized as a town mutual insurance company on July 16, 1878, under the provision of the then existing Wisconsin Statutes. The original name of the company was the Farmers Home Mutual Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used. On February 21, 1999, a stipulation and order allowed the company to convert from a town mutual insurer to a non-assessable mutual insurer authorized under s. ch. 611 Wis. Stat. The order states the company shall maintain a permanent surplus of \$2,000,000, and the company must notify the commissioner 30 days prior to a change in its reinsurance program, and such changes are subject to the disapproval by the commissioner. On July 15, 1999 Waupaca Mutual Insurance Company merged into Ellington Mutual Insurance Company (EMIC), with EMIC being the surviving company.

The company's territory is limited to the state of Wisconsin. In 2000, Ellington wrote direct premium of \$1,266,503.

The major products marketed by the company include farmowner's, homeowner's, inland marine, commercial multiple peril, allied lines and fire. The major products are marketed through thirty-six independent agents.

The following table is a summary of the net insurance premiums written by the company in 2000. The growth of the company is discussed in the Financial Data section of this report.

<b>Line of Business</b>	<b>Direct Premium</b>	<b>Reinsurance Assumed</b>	<b>Reinsurance Ceded</b>	<b>Net Premium</b>
Fire	\$ 46,341	\$ 0	\$ 15,220	\$ 31,121
Allied lines	54,396		17,866	36,530
Farmowner's multiple peril	562,771		184,833	377,938
Homeowner's multiple peril	413,881		135,933	277,948
Commercial multiple peril	93,151		30,594	62,557
Inland marine	95,963		31,518	64,445
	<hr/>	<hr/>	<hr/>	<hr/>
Total All Lines	<u>\$1,266,503</u>	<u>\$ 0</u>	<u>\$415,964</u>	<u>\$850,539</u>

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The board of directors consists of nine members. Three directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting. The board members currently receive \$66 per meeting plus \$.345 per mile for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Alfred G. Krause New London, Wisconsin	Retired	2004
Pat Ruppel Hortonville, Wisconsin	Raises Horses	2004
Steven Frings Waupaca, Wisconsin	Soil Tester	2003
Melvin Krenke Fremont, Wisconsin	Retired	2003
Donald Gehring Appleton, Wisconsin	Farmer	2004
Dean Marcks Shiocton, Wisconsin	Sales	2002
Robert Gralapp New London, Wisconsin	Retired	2002
Arlene Hallman Weyauwega, Wisconsin	Dairy Farmer	2003
Ronald Heise New London, Wisconsin	Salesman	2002



### Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2000 Compensation
Alfred G. Krause	President	\$2,100
Pat Ruppel	Secretary/Treasurer	504
Steven Frings	Vice-President	630

### Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

#### **Adjusting Committee**

Donald Gehring, Chair  
Dean Marcks  
Ronald Heise

#### **Investment Committee**

Steven Frings, Chair  
Robert Galapp  
Pat Ruppel

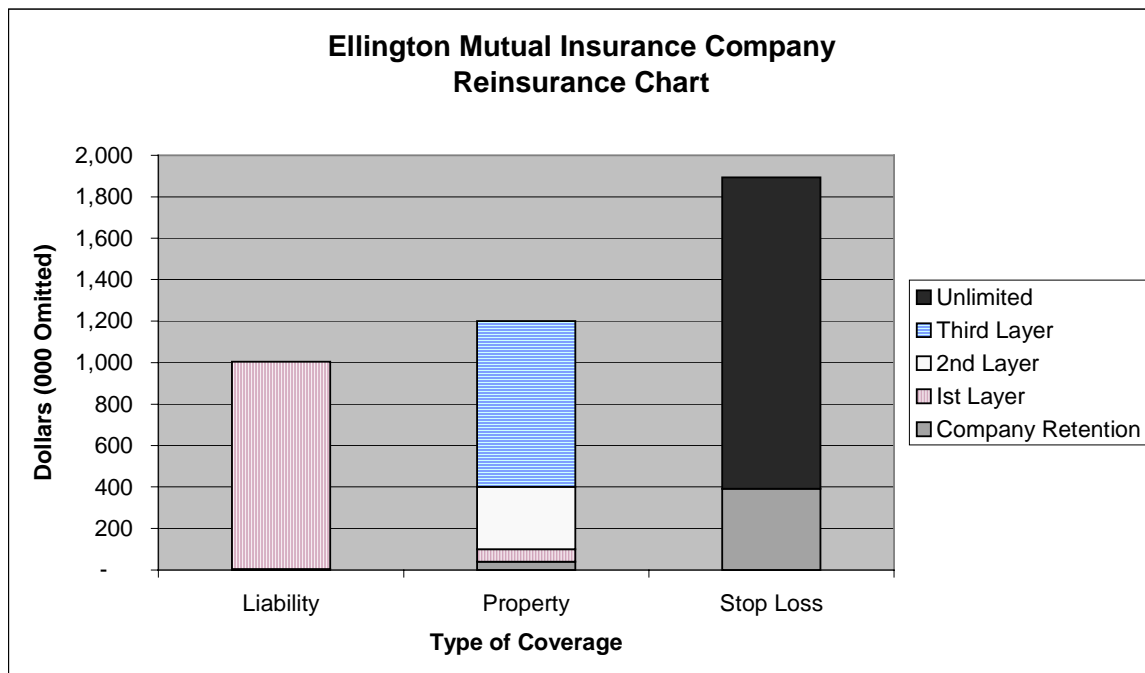
#### **Nominating Committee**

Alfred Krause, Chair  
Robert Galapp  
Ronald Heise  
Pat Ruppel

The board meets once a month and these committees meet on an as needed basis.

## V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. By Stipulation and Order dated February 21, 1999 the company's retention limits, stop-loss and catastrophic coverages under its reinsurance program must comply with that of a town mutual insurer operating under ch. 612 of the Wisconsin Statutes. Any changes to its reinsurance contracts must be submitted 30 days prior to the effective date, and are subject to disapproval by the Commissioner. The company continues to use the reinsurer (Wisconsin Reinsurance Corporation) and the reinsurance program it had as a town mutual. The current contract effective date is January 1, 2001. The company may terminate the contract any January 1 by giving 90 days notice. All coverages stop at the date of termination except Class A which the company can elect a cut off or a run off option and Class B which would be cut off unless otherwise agreed by the reinsurer. The contracts contained proper insolvency provisions.



### Nonaffiliated Ceding Contracts

1. Type: Class A - Liability  
Scope: All liability business written by company  
Retention: \$5,000  
Coverage: 100% of loss in excess of retention  
\$1,000,000 per occurrence single limit  
\$1,000,000 split limits in any combination bodily injury and property damage liability  
\$5,000 for medical payments per person, \$25,000 per accident.  
Premium: 50% of premium written
2. Type: Class B – Excess of Loss First Surplus  
Scope: All property business  
Retention: \$400,000  
Coverage: \$800,000 excess of \$400,000 retention  
Company may cede 50% of risks less than \$400,000  
Premium: 100% of premium of unearned premium to applicable business  
Commissions: 15% provisional commission, 15% when loss percentage is 65% or greater and will increase by 1% for each 1% drop in loss % up to a maximum 35%
3. Type: Class C-1 – Excess of Loss  
Scope: All property business  
Retention: \$40,000  
Coverage: \$60,000 excess of \$40,000 retention  
Premium: Current rate 5%  
Deposit Premium \$48,000  
Minimum Premium \$39,000
4. Type: Class C-2 – Second Excess of Loss  
Scope: All property business  
Retention: \$100,000  
Coverage: \$200,000 excess of \$100,000 retention  
Premium: Deposit Premium \$28,000  
Minimum Premium \$23,000

5. Type:	Class D/E – Stop Loss
Reinsurer:	Wisconsin Reinsurance Corporation
Scope:	All business written by company
Retention:	70% of net premiums written, minimum \$393,000
Coverage:	100% excess of retention
Premium:	Deposit Premium \$147,000 Minimum Premium \$118,000

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported in the December 31, 2000, annual statement to the Commissioner of Insurance. Also included in this section are schedules which reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Members' Surplus per Examination."

**Ellington Mutual Insurance Company**  
**Assets**  
**As of December 31, 2000**

	<b>Ledger Assets</b>	<b>Nonledger Assets</b>	<b>Nonadmitted Assets</b>	<b>Admitted Assets</b>
Bonds	\$1,900,236	\$	\$	\$1,900,236
Stocks:				
Preferred stocks	250,000			250,000
Common stocks	625,362	618,933		1,244,295
Real estate:				
Occupied by the company	240,652			240,652
Cash	352,204			352,204
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	4,248			4,248
Premiums, agents' balances, and installments booked but deferred and not yet due	125,801			125,801
Reinsurance recoverables on loss and adjustment payments	(1,024)			(1,024)
Electronic data processing equipment	11,768			11,768
Interest, dividends, and real estate income due and accrued		32,223		32,223
Other assets nonadmitted:				
Equipment, furniture, and supplies	5,559	8,746	14,305	0
Write-ins for other than invested assets				
Fire Dues Recoverable	34			34
<b>Total Assets</b>	<b><u>\$3,514,840</u></b>	<b><u>\$659,902</u></b>	<b><u>\$14,305</u></b>	<b><u>\$4,160,437</u></b>

**Ellington Mutual Insurance Company**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2000**

Losses	\$ 111,060
Loss adjustment expenses	8,520
Other expenses (excluding taxes, licenses, and fees)	6,306
Taxes, licenses, and fees (excluding federal and foreign income taxes)	2,156
Federal and foreign income taxes (excluding deferred taxes)	40,120
Unearned premiums	<u>609,972</u>
 Total Liabilities	 778,134
 Unassigned funds (surplus)	 <u>3,382,303</u>
 Surplus as Regards Policyholders	 <u>3,382,303</u>
 Total Liabilities, Surplus, and Other Funds	 <u>\$4,160,437</u>

**Ellington Mutual Insurance Company**  
**Summary of Operations**  
**For the Year 2000**

**Underwriting Income**

Premiums earned \$ 809,373

**Deductions**

Losses incurred 609,478

Loss expenses incurred 73,854

Other underwriting expenses incurred 444,593

Total underwriting deductions 1,127,925

Net underwriting loss (318,552)

**Investment Income**

Net investment income earned 155,356

Net realized capital gains or losses 207,760

Net investment gain or loss 363,116

**Other Income**

Finance and service charges not included in premiums 6,540

Write-ins for miscellaneous income:

Miscellaneous income 1,741

Total other income 8,281

Net income before dividends to policyholders and  
before federal and foreign income taxes 52,845

Net income after dividends to policyholders but  
before federal and foreign income taxes 52,845

Federal and foreign income taxes incurred 8,200

Net Income \$ 44,645



**Ellington Mutual Insurance Company**  
**Cash Flow**  
**As of December 31, 2000**

Premiums collected net of reinsurance	\$845,275		
Loss and loss adjustment expenses paid (net of salvage or subrogation)	649,812		
Underwriting expenses paid	<u>425,216</u>		
Cash from underwriting		(\$229,753)	
Investment income (net of investment expense)		151,333	
Other income (expenses):			
Purchase of office equipment	<u>(2,507)</u>		
Total other income		(2,507)	
Deduct:			
Federal income taxes paid		<u>11,760</u>	
Net cash from operations			(\$ 92,687)
Proceeds from investments sold, matured, or repaid:			
Bonds	143,697		
Stocks	<u>363,793</u>		
Total investment proceeds		507,490	
Cost of investments acquired (long-term only):			
Bonds	356,375		
Stocks	<u>221,144</u>		
Total investments acquired		<u>577,519</u>	
Net cash from investments			(70,029)
Cash provided from financing and miscellaneous sources:			
Other cash provided	<u>4,887</u>		
Total		4,887	
Cash applied for financing and miscellaneous uses:			
Other applications	<u>34</u>		
Total		<u>34</u>	
Net cash from financing and miscellaneous sources			<u>4,853</u>
Net change in cash and short-term investments			(157,863)
<b>Reconciliation</b>			
Cash and short-term investments, December 31, 1999			<u>510,067</u>
Cash and short-term investments, December 31, 2000			<u>\$352,204</u>

**Ellington Mutual Insurance Company**  
**Compulsory and Security Surplus Calculation**  
**December 31, 2000**

Assets		\$4,160,437	
Less liabilities		<u>778,134</u>	
Adjusted surplus			\$3,382,303
Annual premium:			
All other insurance	1,266,503		
Factor	<u>20%</u>		
Total		<u>253,301</u>	
Compulsory surplus (subject to a minimum of \$2 million)			<u>2,000,000</u>
Compulsory surplus excess (or deficit)			<u>\$1,382,303</u>
Adjusted surplus			\$3,382,303
Security surplus:			
(140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million with a minimum of 110%)			<u>2,800,000</u>
Security surplus excess (or deficit)			<u>\$ 582,303</u>

**Ellington Mutual Insurance Company  
Reconciliation and Analysis of Surplus  
For the Five Year Period Ending December 31, 2000**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
Surplus, beginning of year	\$2,451,759	\$2,764,857	\$2,958,300	\$3,194,668*	\$3,447,382
Net income	153,059	143,610	(36,996)	201,615	44,645
Net unrealized capital gains or (losses)	161,055	48,720	81,162	48,003	(109,022)
Change in nonadmitted assets	(1,016)	1,113	(7,266)	3,096	(702)
Surplus, end of year	<u>\$2,764,857</u>	<u>\$2,958,300</u>	<u>\$2,995,200</u>	<u>\$3,447,382</u>	<u>\$3,382,303</u>

\*The year-end 1998 surplus and the beginning 1999 surplus do not agree due to the merger with Waupaca Mutual Insurance Company in 1999, which increased surplus by \$199,468.

**Ellington Mutual Insurance Company  
Insurance Regulatory Information System  
For the Two-Year Period Ending December 31, 2000**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period since the company's conversion to a ch. 611 insurer. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios

	<b>Ratio</b>	<b>1999</b>	<b>2000</b>
#1	Gross Premium to Surplus	37.0%	37.0%
#1A	Net Premium to Surplus	24.0	25.0
#2	Change in Net Writings	999.0	2.0
#3	Surplus Aid to Surplus	0.0	0.0
#4	Two-Year Overall Operating Ratio	141.0	94.0
#5	Investment Yield	4.2	3.9*
#6	Change in Surplus	14.0	-1.0
#7	Liabilities to Liquid Assets	18.0	20.0
#8	Agents' Balances to Surplus	0.0	0.0
#9	One-Year Reserve Devel. to Surplus	0.0	0.0
#10	Two-Year Reserve Devel. to Surplus	0.0	0.0
#11	Estimated Current Reserve Def. To Surplus	0.0	-1.0

The company had one exceptional IRIS Ratio. The investment yield ratio was 3.9% or .6% below the minimum. The company has permission from this office to hold one investment that has not paid dividends. The investment ratio without this investment would be 4.6%, within the minimum and maximum range of this ratio.

### Growth of Ellington Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1996	\$3,734,246	\$704,506	\$3,029,740	\$116,976
1997	3,960,289	797,775	3,162,514	89,581
1998	3,913,443	718,765	3,194,668	(69,240)
1999	4,158,596	711,214	3,447,382	201,615
2000	4,160,437	778,134	3,382,303	44,645

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
1996	\$1,173,179	\$ 728,689	\$743,711	61.7%	45.4%	107.1%
1997	1,198,878	778,262	765,632	73.3	45.2	118.5
1998	1,197,908	757,822	753,185	92.1	51.3	143.4
1999	1,271,464	830,998	830,998	41.0	53.8	94.8
2000	1,266,503	850,539	850,539	84.4	54.9	139.3

The company converted from a town mutual insurance company to a ch. 611 insurance company in 1999. Also, in 1999, Waupaca Mutual Insurance Company merged into Ellington Mutual Insurance Company. The first three years of data above included Ellington Mutual Insurance Company's results as a town mutual insurer and the Waupaca Mutual Insurance Company results. Gross premiums written have increased 8.0% from \$1,173,179 in 1996 to \$1,266,503 in 2000. Premiums earned have increased 14.4% from \$743,711 in 1996 to \$850,539 in 2000. Admitted assets increased 11.4% from \$3,734,246 in 1996 to \$4,160,437 in 2000. Liabilities have increased 10.5% from \$704,506 in 1996 to \$778,134 in 2000. Surplus has increase 11.6% in the same time period. The company had a net loss in 1998 but all other years had a net income with this year's net income being \$44,645.

**Reconciliation of Surplus per Examination**

The examination made no adjustments to the \$3,382,303 in policyholders' surplus reported by the company as of December 31, 2000.

## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were three specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Bonds — It is recommended that the company not exceed the 3% of assets limitation in any one issuer of a security except government guaranteed securities pursuant to s. Ins 6.20, (5) (g), Wis. Adm. Code.

Action — Compliance. All bonds were under 3% of assets.

2. Stocks — It is recommended that the company properly report all mutual fund investments in Schedule D of the annual statement as common stock or short-term investments pursuant to the instructions of the NAIC Annual Statement Instructions-Property and Casualty companies.

Action — Compliance. The company had no mutual fund investments.

3. Unearned Premiums — It is recommended that the company correct the error of the doubling of unearned premium balances on policies which incur an endorsement near the expiration date of renewed policies, in order to properly report the unearned portion of premium at year-end pursuant to the NAIC Accounting Practices and Procedures Manual For Property and Casualty Insurance Companies.

Action — Compliance. A review of the unearned and advance premium report noted the problem had been corrected.

## **Summary of Current Examination Results**

### **Unclaimed Funds**

The review of the bank reconciliations revealed that the company has not been setting up a liability for long outstanding checks, but instead added these items back to cash as a reduction to miscellaneous expense in a subsequent period after issuance. It is recommended that the company comply with ch. 177, Wis. Stat., as regards unclaimed funds, and that a liability for unclaimed funds be established in future statutory annual statements to account for all checks outstanding for over one year.

### **Common Stocks**

The company reported incorrect CUSIP numbers for certain securities listed in its annual statement, According to the NAIC Annual Statement Instructions-Property and Casualty: All CUSIP/PPN/CINS numbers entered in this column must conform to those as provided and published by the Securities Valuation Office (SVO). It is recommended that the company report the correct CUSIP numbers for its securities in accordance with the NAIC Annual Statement Instructions-Property and Casualty.

### **EDP Equipment**

During the review of EDP Equipment depreciation schedule it was discovered that the company had included non-operating or applications software as a statutory asset. According to the NAIC Accounting Practices and Procedures Manual for Fire and Casualty Companies: Electronic Data Processing Equipment: Application systems software may be expensed when purchased or established as a nonadmitted asset and written off over a period of years not to exceed the software's expected useful life. It is recommended that the company either expense or nonadmit application software according to the NAIC Accounting Practices and Procedures Manual for Fire and Casualty Companies.

## **Deferred Premiums**

Deferred premiums are those installments becoming effective after year-end, for policies that are in-force at year-end. The company derives its annual statement balance for deferred premiums from a “Deferred Installment Report”. This report excludes December billings for installments that become effective in the subsequent year. The effect is an understatement of deferred premium and policyholder surplus. To arrive at the exact dollar amount of the understatement would be prohibitively time-consuming. For this reason and because the error resulted in a more conservative representation of surplus, no adjustment was made to the examination balance. However, it is recommended that the company include in deferred premium, all installments that are effective after year-end on policies in-force at year-end.

## **Premiums in Course of Collection**

- ❖ The company derives its premiums in course of collection balance from a current receivable report, which incorrectly includes policies billed before year-end, but not becoming effective until the subsequent year. In order to correct this problem, the company also runs a report of these billed in advance items at year-end, which is then subtracted from the current receivable report to arrive at premiums in course of collection. However, the billed in advance report also includes advance premium items, defined as those policies where cash is received prior to year-end and related to effective dates subsequent to year-end. The methodology used by the company results in advance premium being netted against premiums in course of collection, which is contrary to the guidance provided by SSAP 53 of the NAIC Accounting Practices and Procedures Manual. It is recommended that the company report premium received in advance as a separate liability, and not as an offset to premiums in course of collection.



## **VIII. CONCLUSION**

The company converted to a ch. 611 nonassessable company in 1999. Also in 1999, Waupaca Mutual Insurance Company merged into Ellington. Admitted assets increased 11.4% from \$3,734,246 in 1996 to \$4,160,437 in 2000. Liabilities increased 10.5% from \$704,506 in 1996 to \$778,134 in 2000. Surplus increased 11.6% from \$3,029,740 in 1996 to \$3,382,303 in 2000. The company had net income for four out of the five years under examination. The net income in 2000 was \$44,645.

The examination had five recommendations, which are listed in the next section of this report.

## IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 20 Unclaimed Funds — It is recommended that the company comply with ch. 177, Wis. Stat., as regards unclaimed funds, and that a liability for unclaimed funds be established in future statutory annual statements to account for all checks outstanding for over one year.
2. Page 20 Common Stocks — It is recommended that the company report the correct CUSIP numbers for its securities in accordance with the NAIC Annual Statement Instructions-Property and Casualty.
3. Page 20 EDP Equipment — It is recommended that the company either expense or nonadmit application software according to the NAIC Accounting Practices and Procedures Manual for Fire and Casualty Companies.
4. Page 21 Deferred Premiums — It is recommended that the company include in deferred premium, all installments that are effective after year-end on policies in-force at year-end.
5. Page 21 Premiums in Course of Collection — It is recommended that the company report premium received in advance as a separate liability, and not as an offset to premiums in course of collection.

## **X. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Jean Suchomel	Insurance Financial Examiner
Rebecca Easland	Insurance Financial Examiner

Respectfully submitted,

David A. Grinnell  
Examiner-in-Charge